Being Real About Governance

by Caroline Oliver

Caroline Oliver, Editor of Board Leadership*, suggests that better governance would be served if we were more willing to face the limitations of our current understanding and practice. Here, she starts the process for herself and asks you to do the same.*

As someone who has taken a very close interest in governance for over twenty years, it seems to me worth asking the question that every child asks from the back seat of their parents' car on a long and winding road: "Are we there yet?" Like a child, I often ask the question in a rather imperious and despairing voice ("For heaven's sake, can't you lot in the front seat get us there any faster than this?"). And, like a child, maybe I don't understand, or take any responsibility for, the realities of what it is going to take to get us from A to B.

In this article, I try to start putting that right for myself and hope that you may come some or all of the way with me. Please note that, throughout this article, I am using the word *governance* to denote the work of the board.

Noble Aims

The first question to ask, of course, is where are we trying to get to? I suspect that the answer for all of us is something along the lines of "governance that enables organizations to succeed." A noble aim indeed, but clearly one that begs at least two further questions:

1. How should success for any given organization be defined?

2. How can governance impact success or failure?

> For all the increased research and focus on governance since the very first report on corporate governance, we still have no agreement on the answers to the most basic of questions.

FOOD FOR THOUGHT

"The best way of reducing error rates is to target the underlying systems failures, rather than take action against individual members of staff."

Leape, L. L. "Striving for Perfection," *Clinical Chemistry* 48, no. 11 (2002): 1871–1872.

How We Fall Short

Asking these two seemingly simple questions reveals the fundamental reality that we must face if we are to be real about governance. For all the increased research and focus on governance since the very first report on corporate governance,[1] we still have no agreement on the answers to the most basic of questions.

On the question of how success should be defined for any given organization, the legal framework in many jurisdictions would say we must look to "the best interests of the corporation." As Tuvia Borok points out in the context of the Canadian Business Corporations Act (CBCA)[2]: "A consideration of any corporate law issue … ultimately leads to a deliberation of how to define what the best interests of a corporation are."

The CBCA demands that "every director and officer of a corporation, in exercising their powers and discharging their duties shall act honestly and in good faith, with a view to the best interests of the corporation."[2] Yet courts and academics disagree as to the appropriate definition of "acting in the best interests of the corporation."[3]

In the absence of this definition, many claims arise. Perhaps "the best interests of the corporation" can be equated with the best interests of shareholders, or employees, or stakeholders, or the local community, or the people represented by the incorporating body? Or maybe all of them? And it doesn't help our search for clarity to know that each of these terms is open to a large number of different interpretations.

In the United Kingdom, the Companies Act 2006 requires that directors consider the impact of their actions on a wide range of stakeholders. The Act requires a director to "promote the success of the company for the benefit of its members as a whole," but sets out the following six factors a director must consider in fulfilling the duty to promote success:[4]

1. The likely consequences of any decision in the long term.

2. The interests of the company's employees.

3. The need to foster the company's business relationships with suppliers, customers, and others.

4. The impact of the company's operations on the community and the environment.

5. The desirability of the company maintaining a reputation for high standards of business conduct.

6. The need to act fairly as between members of a company.

To put the position briefly, board members can be forgiven for being confused about whose interests should come first when it comes to defining success.

On the second basic question of "How can governance impact success or failure?" we are also falling short of our noble aim of "governance that enables organizations to succeed" as those associated with FIFA, Volkswagen, and charities such as Kids Wish Network, among many others, can attest.[5] Writing about Volkswagen in the October 2015 issue of Boardroom Insider, Ralph Ward says:

> *Not only are the supervisory board chair and CEO positions separate, the chief executive … cannot even sit on the supervisory board. When it comes to governance, Germany sits near the top in global rankings on the rule of law in business, solid regulatory structures, low corruption, and audit integrity. … All good—and yet none of this created internal controls that could stop or detect a massive, international emissions tampering scandal. Volkswagen's supervisory board has launched an investigation to learn what happened and who is responsible—not only didn't their internal controls spot the mischief, they still can't determine how extensive the tampering is, who was involved, and in what countries.*

He concludes: "… Volkswagen is a company in a governance zone that should have seen everything done right. If their controls failed them so disastrously, what could your company's internal controls be missing right now?"[6]

When things go wrong—as we have seen time after time from Enron onwards—given that no one can be expected to know everything about everything, we still don't know what boards should and should not know about what, nor what CEOs should and should not know about what. We still don't know whose head or heads should roll.

Is Perfect Governance Even Possible?

T. S. Eliot's suggestion that ultimately we are all trying to escape the darkness within and without by "dreaming of systems so perfect that no one will need to be good"[7] has much merit. The very best of boards using the very best of governance systems and the very best of CEOs using the very best of management systems have to give others some freedom to get the job done. This inevitably involves some element of trust and, equally inevitably, sometimes there will be failures. As our world gets more and more complex, more and more employees know more about many things than their employers can ever hope to know. Some things will always be beyond the capacity of the average board member or CEO to understand. Even third parties that boards and CEOs hope they can rely on to assure the veracity of the data they are receiving will fail. In many scandals we find ourselves asking not only "Where were the directors?" but also "Where were the auditors, the regulators, and the testing agencies?"

As Baroness Onora O'Neill points out:[8]

> *Trusting intelligently gets harder when tasks are more complex. Most of us cannot judge the products marketed by the financial services industry, or by insurers. Most of us cannot assess scientific claims or new technologies. In these complex cases we can place and refuse trust intelligently only by finding proxy evidence of trustworthiness, since the complete evidence is too complicated for the less expert. We can all think of examples of useful proxy evidence provided by*

WHEN WE SAY …

Board Leadership's mission is "to discover, explain, and discuss innovative approaches to board governance with the goal of helping organizations achieve effective, meaningful, and successful leadership to fulfill their missions."

Board Leadership aims to fulfill this mission by engaging its readers in a lively and illuminating inquiry into how board governance can be made more effective. This inquiry is based on three key assumptions:

- Boards exist to lead organizations; not merely monitor them.
- Effective board governance is not about either systems, structures, processes, theories, practices, culture, or behaviors—it is about all of them.
- Significant improvements are likely to come only through challenging the status quo and trying out new ideas in theory and in practice.

Uniquely among regular publications on board governance, *Board Leadership* primarily focuses on the job of board leadership as a whole, rather than on individual elements of practice within the overall job.

Over time, *Board Leadership* will provide a repository of different approaches to governance created through its regular "One Way to Govern" feature.

Here's what a few of the key terms we use mean to us:

- **Innovative:** Creating significant positive change.
- **Approaches to:** principles, theories, ideas, methodologies, and practices.
- **Board governance:** The job of governing whole organizations. ❑

experts. In the best cases, auditors, examiners, regulators, evaluators, peer reviewers and experts of other sorts can judge trustworthiness, and then offer an intelligible summary that serves as proxy evidence for the less expert. Most of us can unfortunately also think of cases in which the proxy evidence provided by experts was too complex, irrelevant or unusable, so could not support the intelligent placing and refusal of trust.

What Will It Take to Close the Gap?

So is it hopeless? Should we just accept that the answer to the question "Are we there yet?" is "No, and we never will be"?

Clearly, we do have to accept that we are never going to be able to 100 percent guarantee that we have "governance that enables organizations to succeed" permanently in place in every organization across the globe. However, I do believe that getting closer to where we want to get to is only impossible if we give up the quest. I also believe that we have a moral obligation to try. Organizations are human creations, and therefore we are responsible for bringing them into being and ensuring, as far as we possibly can, that they do indeed fulfill the purposes for which we created them.

Indeed, it seems to me that the first thing we can do to close the gap between where we are and our ultimate goal revolves around the issue of organizational purpose. Defining success is fundamentally about defining purpose. There are undoubtedly lots of people that boards should listen to and take account of in considering purpose, but we have to be clearer than we are today about who the ultimate arbiters of purpose are. Not all stakeholders are created equal, and I want to suggest that there is a significant difference between those whose interests a wise board would consider and those to whom the board is ultimately accountable. I further want to suggest that it is only the interests of the latter group that should be considered the ultimate legitimators of purpose.

> Not all stakeholders are created equal, and I want to suggest that there is a significant difference between those whose interests a wise board would consider and those to whom the board is ultimately accountable.

My fear is that much of the discussion today is serving to muddy the waters and therefore to obscure rather than illuminate accountability. I therefore believe that one major thing we could do to help close the gap between where we are today and "governance that enables organizations to succeed" is to establish legal and practice frameworks that clarify to whom boards are ultimately accountable for the definition of organizational purpose as distinct from their other accountabilities to other persons.

Turning to the question of "How can governance impact success or failure?" I think we can do a whole lot better at fleshing out the board's crucial role as the highest authority within an organization—a role that encompasses leadership as well as stewardship on behalf of those to whom the board is ultimately accountable. We need to be clear what it is reasonable to hold boards accountable for doing and knowing, and that means we need clear job design, not merely the bolting together of bits and pieces that seem to make sense individually. And boards need to be clear about what they are delegating to whom with what authorities and accountabilities—which again calls for clear job design.

In other words, I believe that getting real about governance means facing the fact that it is not something that can be left to each board to invent for itself based on the opinions of the board members of the day. Closing the gap between where we are today and "governance that enables organizations to succeed" requires all those involved in governance in every sphere to work together to clarify principles and practices that can be systematically applied to the job, no matter who is carrying it out at any given time.

Yes, there will always be failures, but can we not build systems that ensure that we can clearly see what has gone wrong at what level and all learn from every failure? Can we not find ways of clearly stating our expectations of each other? Can we not aim to get to a place where we can hold all involved at every level accountable for providing intelligible evidence of their fulfillment of those expectations and the integrity of that evidence?

I believe that the Policy Governance system[9] provides a great starting point for getting real about governance, which is why I have been involved in teaching it and promoting

(continued on page 8)

WRITING FOR *BOARD LEADERSHIP*

Board Leadership **welcomes articles from governance practitioners, researchers, and consultants on topics related to the discovery, explanation, and discussion of innovative approaches to board governance. If you have something new to say or want to provide a new perspective on something already said, please get in touch to discuss your idea further and to get a copy of our publishing criteria. Email: coliver@goodtogovern.com** ❑

The Complexity Gap

(continued from page 3)

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8. See, for instance: Jaques, E. A. *General Theory of Bureaucracy* (London: Heinemann Educational, 1976); Habermas, J. *Legitimation Crisis* (T. McCarthy, Trans.). (Boston, MA: Beacon Press, 1975); Kegan, R. *In Over Our Heads: The Mental Demands of Modern Life* (Cambridge, MA: Harvard University Press, 1994); and Bell, D. *The Coming of Post-industrial Society* (New York: Basic Books, 1973).

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13. The latest estimations around the distribution of developmental levels in adulthood can be seen in Dawson, T. L. "Lectical levels in adulthood," November 17, 2015, http://theodawson.net/?p=447.

Being Real

(continued from page 6)

it throughout my career. However, we need many more people to know about it and to engage in understanding and challenging it, as well as seeking to enhance it and develop better alternatives to it, if we are truly going to get to "governance that enables organizations to succeed." ❑

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Notes

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2. Canadian Business Corporations Act (CBCA). Act current to 2015-11-24 and last amended on 2015-02-26. http://laws-lois.justice.gc.ca/eng/acts/C-44/page-19.html?txthl=best%20interests%20of%20the%20corporation#s-122

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9. See www.carvergovernance.com and www.policygovernanceassociation.org for more on the Policy Governance system.

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